Legislative statement: Financial Sector (Climate-related Disclosures and Other Matters) Amendment Bill – Third Reading

Introduction

The Financial Sector (Climate-related Disclosures and Other Matters) Amendment Bill (**the Bill**) is an omnibus Bill that amends the Financial Markets Conduct Act 2013 (**FMC Act**), the Financial Reporting Act 2013 (**FR Act**) and the Public Audit Act 2001.

Background

The Bill introduces a mandatory climate-related disclosure regime for specified FMC reporting entities under the FMC Act (**climate reporting entities**), including most debt and equity issuers listed on the NZX. It will also apply to large registered banks, non-bank deposit takers, licensed insurers, and registered investment scheme managers. The Bill will require these entities to make climate-related disclosures on their climate risks and opportunities, and report on how these affect their business, or any fund they manage.

The main goals of the Bill are to:

- Ensure that the effects of climate change are routinely considered in business, investment, lending and insurance underwriting decisions
- Help climate reporting entities better demonstrate responsibility and foresight in their consideration of climate issues
- Lead to smarter, more efficient allocation of capital, and help smooth the transition to a more sustainable, low emissions economy.

Phased implementation

The Bill will be implemented in three phases. The changes to the FR Act will come into the force on the day after the date of the Royal assent. This will enable the External Reporting Board (**XRB**) to issue climate standards from this date.

The substantive provisions in the Bill including the requirement to make climate-related disclosures will commence no later than one year after Royal assent. This can only happen after the XRB has issued at least one climate standard.

The last phase, which will come into force no later than the third anniversary after Royal assent, provides for mandatory assurance of greenhouse gas (**GHG**) emissions and includes the amendments to the Public Audit Act 2001.

Climate-related disclosures for certain FMC reporting entities with higher levels of public accountability

Part 7 of the FMC Act requires FMC reporting entities to prepare and publish financial statements in accordance with generally accepted accounting practice. The Bill adds a new Part 7A to the FMC Act, which will provide for approximately 200 FMC reporting entities to also be climate reporting entities. Climate reporting entities will be required to:

- keep proper records relating to their obligations to make climate-related disclosures
- prepare annual climate statements in accordance with climate standards issued by the XRB

- lodge those statements on the Disclose Register
- obtain an assurance engagement in relation to their GHG emissions disclosures.

The offences and penalties in new Part 7A are aligned with existing Part 7 for financial reporting. It is an offence under new s461ZC for a climate reporting entity or its director to lodge a climate statement knowing that it fails to comply with the applicable climate standard. Upon conviction, a climate reporting entity is liable to a fine not exceeding $2.5 million; while an individual is liable for imprisonment for a term not exceeding 5 years, or a fine not exceeding $500,000, or both. This offence is similar to s461I in the FMC Act for failure to comply with financial reporting standards.

Enabling the XRB to prepare and issue climate-related reporting standards

The Bill provides for the XRB to issue climate standards by amending the FR Act. This is an expansion of the XRB's existing functions.

Provisions in the Bill also amend the FR Act to widen the XRB membership qualifications to include people with experience in sustainability (for example, climate change). This reflects the expertise required for the XRB to perform its new responsibilities. The XRB has also been given a new power to issue non-binding guidance on integrated reporting (new s19A). This new function is in response to demand for best practice guidance on environmental, social and governance reporting and other non-financial disclosures.

The FMA will be the independent regulator for climate reporting entities

Monitoring and enforcement of the disclosure regime are essential parts of the Bill. The FMA will be responsible for these functions as the independent regulator using its existing powers under the FMC Act and Financial Markets Authority Act 2011.

The Auditor-General to act as assurance practitioner for climate reporting entity that is public entity

The Public Audit Act 2001 is also amended as some climate reporting entities are also "public entities" as defined in s5 of that Act. The amendments state that the Auditor-General is the assurance provider for all climate reporting entities that are public entities.

Key changes to the Bill recommended by the Economic Development, Science and Innovation Committee (the Committee)

Three key changes recommended by the Committee are:

- the definition of a climate reporting entity
- the removal of the disclose-or-explain provisions
- changes to the assurance provisions.

As introduced, all listed issuers of quoted equity securities or quoted debt securities are climate reporting entities. The Committee recommended that small listed issuers and entities listed on growth markets should be excluded from the climate-related disclosure regime. Small issuers and growth markets were exempted because of the risk such entities would not be able to access capital without disproportionate compliance cost barriers. The majority of the financial sector are still captured by the Bill notwithstanding the exemption for small issuers and growth markets.

Originally the Bill provided a disclose-or-explain exception if a climate-reporting entity determined that it was not materially affected by climate change. This allowed climate reporting entities to "explain" via a report why they were not materially affected. The disclose-or-explain provisions have been removed from the Bill to remove the "two-tier" reporting system. This approach ensures

that users are better able to compare reports, and that all climate reporting entities are analysing their risks and opportunities. Any need for differential reporting can be achieved through the application of the climate standards.

The Committee recommended these changes to the assurance provisions:

- delay implementing the assurance requirements for an additional two years
- remove the assurance practitioner licensing and accreditation provisions
- add a criminal offence for non-compliance with applicable assurance standards.

Independent assurance is vital for ensuring the integrity and credibility of any disclosures. As introduced, Part 1 of the Bill, which included the assurance requirements, would come into force within one year of Royal assent. Delaying implementation of assurance of GHG emissions for an additional two years will allow the audit and assurance industry to build and grow professional capacity to report against the applicable audit and assurance standards.

To address the Committee's concerns about the effectiveness of the assurance practitioner licensing and accreditation provisions, the Committee recommended removing them from the Bill. This will allow time for a fit-for-purpose regime to be designed.

The Committee also recommended inserting a new provision making it an offence, liable to a fine not exceeding $50,000, for an assurance practitioner to contravene applicable assurance standards. However, following feedback from stakeholders, the offence has been removed by operation of a Government Supplementary Order Paper (**SOP**) which is discussed below.

Government Supplementary Order Paper

Three key technical changes were made via the SOP. The first is that the test for measuring the size of a listed debt issuer has been changed. The Committee recommended that only large listed issuers should be covered by the reporting regime and at the time this was determined by reference to the market capitalisation of the issuer. The SOP makes a technical change here to remove the definition of market capitalisation so that the size of a debt issuer can be measured by reference to the face value of its quoted debt securities rather than the net assets of the issuer. The size of an equity issuer continues to be measured by reference to the market price or fair value of all of the issuer's equity securities. (Whether there is a reference to market price (for equity issuers) or face value (for debt issuers) the amount that must be exceeded for an issuer to be large is $60 million.

The second change in the SOP relates to the requirement for a qualified assurance practitioner's report to be sent to the regulators. The SOP extends the timeframe from seven working days after signing to twenty working days.

The third change in the SOP provides that it is no longer an offence if an assurance practitioner's report does not comply with the requirements of all applicable auditing and assurance standards.